

Office of the State Auditor

Division of State Audit

Office of Administrative Hearings Bismarck, North Dakota

Audit Report for the
Biennium Ended June 30, 2007
Client Code 140

Robert R. Peterson
State Auditor



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Contents

<i>Transmittal Letter</i>	<i>1</i>
<i>Executive Summary</i>	<i>2</i>
<i>Introduction</i>	<i>2</i>
<i>Responses to LAFRC Audit Questions</i>	<i>2</i>
<i>LAFRC Audit Communications</i>	<i>3</i>
<i>Audit Objectives, Scope, and Methodology</i>	<i>5</i>
<i>Management’s Discussion and Analysis</i>	<i>7</i>
<i>Financial Summary</i>	<i>7</i>
<i>Analysis of Significant Changes in Operations</i>	<i>8</i>
<i>Financial Statements</i>	<i>9</i>
<i>Statement of Revenues and Expenditures</i>	<i>9</i>
<i>Statement of Appropriations</i>	<i>10</i>
<i>Internal Control</i>	<i>11</i>
<i>Fraud Risk Assessment</i>	<i>12</i>
<i>Compliance With Legislative Intent</i>	<i>13</i>
<i>Operations</i>	<i>14</i>
<i>Management Letter (Informal Recommendations)</i>	<i>15</i>

Transmittal Letter

May 21, 2008

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Mr. Allen Hoberg, Director, Office of Administrative Hearings

We are pleased to submit this audit of the Office of Administrative Hearings for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Angela Sabot. Kevin Scherbenske, CPA, was the staff auditor. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2320. We wish to express our appreciation to Director Hoberg and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota Office of Administrative Hearings is an executive branch agency that provides independent administrative law judges to preside at administrative hearings and related proceedings. The agency is authorized to provide administrative law judges to preside at state agency, local government agency, tribal government, and judicial branch hearings and related proceedings.

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Office of Administrative Hearings in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing "fraud risk assessment" (page 12), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

There were no recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 15 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Office of Administrative Hearings' financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), and the Billing System (the system used by the Office of Administrative Hearings to track their accounts receivable), are high-risk information technology systems critical to the Office of Administrative Hearings.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Office of Administrative Hearings for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Office of Administrative Hearings' operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Office of Administrative Hearings and are they in compliance with these laws?
3. Are there areas of the Office of Administrative Hearings' operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Office of Administrative Hearings is for the biennium ended June 30, 2007. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Office of Administrative Hearings has operations in the following locations. Each location will be included in the audit scope:

- The main office located in Bismarck.
- A field office located in West Fargo.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer assisted auditing techniques. These procedures were used to identify high risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to

determine if controls were operating effectively and to determine if laws were being followed consistently. Nonstatistical sampling was used and the results were projected to the population. Further where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) ERP system. Given the complexity of the State's accounting system, significant evidence was obtained from ConnectND.
- Observed the Office of Administrative Hearings' processes and procedures.

In aggregate there were not any significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Management's Discussion and Analysis

The accompanying financial statements have been prepared to present the Office of Administrative Hearings' revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

The following management discussion and analysis was prepared by the Office of Administrative Hearings' management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the biennium ended June 30, 2007, operations of the Office of Administrative Hearings were entirely supported by appropriations of special funds. These funds are obtained by the Office of Administrative Hearings billing all user agencies for hearing officer services.

FINANCIAL SUMMARY

The Office of Administrative Hearings' total revenues were \$1,573,746 for the biennium ended June 30, 2007, as compared to \$1,320,130 for the biennium ended June 30, 2005. The Office of Administrative Hearings received no general fund appropriation for the 2005-2007 biennium.

Total expenditures for the Office of Administrative Hearings were \$1,377,936 for the biennium ended June 30, 2007, as compared to \$1,170,951 for the prior biennium. Expenditures remained fairly constant.

Payments for professional services accounted for approximately 15.4% of total expenditures during the fiscal years reviewed. Such services relate primarily to contracts with temporary administrative law judges to conduct Workforce Safety and Insurance hearings.

ANALYSIS OF SIGNIFICANT CHANGES IN OPERATIONS

There were no significant program changes for the Office of Administrative Hearings during the period audited. The Office of Administrative Hearings continued to provide all hearing officer services for Workforce Safety and Insurance, a program it started by mutual agreement with WSI in September 1995 and continued to take requests for services from other agencies required and not required to use the Office of Administrative Hearings.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
<u>Revenues and Other Sources:</u>		
Charges for Services	\$814,925	\$757,594
Miscellaneous Refunds		1,227
Total Revenues and Other Sources	<u>\$814,925</u>	<u>\$758,821</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$523,679	\$491,445
Major Operating Expenditures:		
Professional Services	119,162	92,710
Rent – Building	23,398	22,756
Data Processing	15,203	15,443
Travel	10,314	13,523
Other Operating Expenditures	23,112	27,191
Total Expenditures and Other Uses	<u>\$714,868</u>	<u>\$663,068</u>

STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 1,042,927		\$ 1,042,927	\$ 1,013,135	\$ 29,792
Operating Expenses	266,917	\$ 200,000	466,917	364,801	102,116
Totals	<u>\$ 1,309,844</u>	<u>\$ 200,000</u>	<u>\$ 1,509,844</u>	<u>\$ 1,377,936</u>	<u>\$ 131,908</u>
Expenditures by Source:					
Other Funds	\$ 1,309,844	\$ 200,000	\$ 1,509,844	\$ 1,377,936	\$ 131,908
Totals	<u>\$ 1,309,844</u>	<u>\$ 200,000</u>	<u>\$ 1,509,844</u>	<u>\$ 1,377,936</u>	<u>\$ 131,908</u>

Appropriation Adjustments:

NDCC 54-57-07(3) states that money in the administrative hearings fund is continually appropriated as necessary for numerous uses by the Office of Administrative Hearings, including payment to temporary administrative law judges. Two adjustments were made to increase the spending authority of the Operating Expenses line for this purpose. The first increase was on July 27, 2006 and the second was on November 20, 2006.

Internal Control

In our audit for the biennium ended June 30, 2007, we identified the following areas of the Office of Administrative Hearings' internal control as being the highest risk:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the computer-based billing system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiency in internal control. We also noted other matters involving internal control that we have reported to management of the Office of Administrative Hearings in a management letter dated May 21, 2008.

FRAUD RISK ASSESSMENT

Finding 07-1

The Office of Administrative Hearings does not have a system in place to identify possible instances of fraud or fraudulent activities in their financial and operational areas.

The most important guidance relating to internal control is contained in *Internal Control – Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This guidance dictates that a Fraud Risk Assessment program be established and practiced to identify risks of fraudulent type activities, including when special circumstances arise, when changing operating environments, and for restructuring. In addition, the Office of Administrative Hearings does not have the necessary control activities designed/documented to ensure significant fraud exposures are identified and mitigated. Management must design the necessary internal controls to ensure that each of the significant fraud exposures identified during the risk assessment process are adequately mitigated.

The Office of Administrative Hearings was unaware of this requirement.

Audit Recommendation and Agency Response

Recommendation:

We recommend the Office of Administrative Hearings perform periodic fraud risk assessments and properly address significant risks that are identified.

Office of Administrative Hearings Response:

We agree with the finding and will perform annual fraud risk assessments according to suggested guidelines and properly address significant risks that are identified during an assessment.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2007, we identified and tested the Office of Administrative Hearings' compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Included In Our Audit Scope

- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations (2005 North Dakota Session Laws, Chapter 45).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that have occurred or are likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the Office of Administrative Hearings in a management letter dated May 21, 2008.

Operations

This audit did not identify areas of the Office of Administrative Hearings' operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

May 21, 2008

Mr. Allen C. Hoberg, Director
Office of Administrative Hearings
1707 North 9th Street
Bismarck, ND 58501-1882

Dear Mr. Hoberg:

We have performed an audit of the Office of Administrative Hearings for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the Office of Administrative Hearings' internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

CASH

Informal Recommendation 07-1: We recommend the Office of Administrative Hearings strengthen controls surrounding cash receipting and accounts receivable by adequately segregating the necessary duties.

LAWS AND REGULATIONS

Informal Recommendation 07-2: We recommend the Office of Administrative Hearings comply with OMB policy 112 by properly completing required criminal history background checks on all new hires who have access to personal information in the PeopleSoft system.

Informal Recommendation 07-3: We recommend the Office of Administrative Hearings comply with state procurement policies and NDCC 54-44.4-02.1.

PAYROLL

Informal Recommendation 07-4: We recommend the Office of Administrative Hearings have an individual without payroll access print and approve the One-Time Payment query on a monthly basis.

INTERNAL CONTROL

Informal Recommendation 07-5: We recommend the Office of Administrative Hearings expand their Code of Conduct to include all employees of the agency. We recommend the Code of Conduct be periodically communicated to all covered employees and that all employees confirm their receipt and reading of the Code of Conduct on at least an annual basis.

Management of the Office of Administrative Hearings agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Angela Sabot
Auditor in-charge